

## CREDIT OPINION

28 April 2016

### New Issue

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## City of Muscatine, IA

New Issue: Moody's assigns Aa2 to Muscatine, IA's \$4.6M GO Bonds, Ser. 2016

### Summary Rating Rationale

Moody's Investors Service has assigned a Aa2 rating to the City of Muscatine, IA's \$4.6 million General Obligation Corporate Purpose and Refunding Bonds, Series 2016. Moody's maintains the Aa2 rating on the city's outstanding general obligation unlimited tax (GOULT) debt. The Aa2 rating reflects the city's stable, moderately-sized tax base located along the Mississippi River; trend of positive financial operations and improving reserve levels; manageable debt burden; and moderate exposure to unfunded pension liabilities.

### Credit Strengths

- » Stable local economy with low unemployment
- » Sound financial management with improving reserve levels

### Credit Challenges

- » Smaller tax base and weaker socioeconomic characteristics compared to similarly rated entities
- » Moderate degree of concentration among top taxpayers

### Rating Outlook

Outlooks are typically not assigned to local government credits with this amount of debt.

### Factors that Could Lead to an Upgrade

- » Significant expansion and diversification of the tax base
- » Strengthening of socioeconomic characteristics
- » Continued growth in reserves, bolstering financial flexibility and liquidity

### Factors that Could Lead to a Downgrade

- » Trend of imbalanced financial operations leading to material declines in reserves
- » Weakening of the local economy as evidenced by valuation declines, increased unemployment, or a fall in the city's socioeconomic profile
- » Substantial increase in the city's debt burden

## Key Indicators

Exhibit 1

Exhibit 2

Muscatine (City of) IA	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value (\$000)	\$ 1,220,461	\$ 1,227,291	\$ 1,238,312	\$ 1,263,280	\$ 1,321,462
Full Value Per Capita	\$ 53,328	\$ 53,626	\$ 54,108	\$ 55,199	\$ 57,741
Median Family Income (% of US Median)	88.4%	87.0%	85.4%	84.8%	84.8%
Finances					
Operating Revenue (\$000)	\$ 17,254	\$ 18,391	\$ 18,409	\$ 19,140	\$ 20,166
Fund Balance as a % of Revenues	15.4%	20.2%	19.9%	20.4%	22.2%
Cash Balance as a % of Revenues	12.4%	19.0%	17.7%	21.4%	24.5%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 17,555	\$ 18,270	\$ 17,450	\$ 17,530	\$ 15,075
Net Direct Debt / Operating Revenues (x)	1.0x	1.0x	0.9x	0.9x	0.7x
Net Direct Debt / Full Value (%)	1.4%	1.5%	1.4%	1.4%	1.1%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	1.9x	2.2x	2.4x	2.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	2.9%	3.2%	3.7%	3.4%

Post-sale, Net Direct Debt is estimated at \$18.4 million, or 0.9 times operating revenue and 1.4% of full value.

Source: Audited Financial Statements; Moody's Investors Service

## Detailed Rating Considerations

### Economy and Tax Base: Moderately Sized Tax Base Located Along Mississippi River in Southeast Iowa

Moody's expects continued tax base stability given an expanding commercial and industrial presence, though economic concentration remains elevated. Located in southeast Iowa (Aaa Stable) along the Mississippi River, the city's \$1.3 billion tax base grew at a moderate average annual rate of 1.7% since 2010. While a majority of the city's taxable valuation is residential (59% in 2014), the primary driver of the recent valuation trends has been development within the commercial and industrial sectors (41%). The city's two largest taxpayers, Grain Processing Corporation (GPC, 4.8% of 2014 taxable value) and HNI Corporation (also known as Hon Industries, 3.7% of 2014 taxable value) are both headquartered in the city, slightly mitigating challenges associated with taxbase and economic concentration. GPC is currently undertaking a \$110 million expansion and improvement of their existing plant. Hon Industries, which is also the city's largest employer with an estimated 3,700 employees, is in the process of making \$40 million of expansions and improvements in their downtown manufacturing plant. At 5.1% as of February 2016, unemployment in Muscatine County exceeds that of the state (4.5%) but is in line with the national (5.2%) rates for the same period. According to data from the US Census Bureau's American Community Survey, the city's median family income stands at 84.8% of the national median. Partially offsetting the below average resident wealth levels is the city's relatively affordable housing stock, with 2014 median home values at 58.1% of the national median.

### Financial Operations and Reserves: Balanced Financial Operations Expected to Continue

We expect the city's financial position to remain stable given management's demonstrated history of conservatively budgeting revenues and expenditures. Fiscal 2015 marked the city's eighth consecutive surplus in its Operating Fund (comprised of the General and Debt Service Funds), growing the available fund balance to \$4.5 million, or a satisfactory 22.2% of operating revenues. Given the city's surplus operations in recent years, officials are planning to utilize up to \$271,000 of reserves in fiscal 2016 for various one time expenditures. Similarly, officials anticipate using up to \$191,000 of reserves in fiscal 2017. Despite the planned draws, reserve levels are expected to remain in excess of the city's formal fund balance policy, which calls for the maintenance of at least 16.7% (or two months) of expenditures.

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Property taxes comprised 47% of Operating Fund revenues in fiscal 2015. The city levies the statutory maximum \$8.10 for general operations, but is not levying its \$0.27 emergency levy nor is it levying its fully available employee benefits levy. If the city were to levy the full amount for both of these levies in fiscal 2017, it would generate an additional \$415,000 in revenue. Additionally, the city retains the ability to increase its utility franchise fee from 1.0% to 5.0%, which would result in an estimated \$400,000 of additional revenue. The city also has a 1% Local Option Sales Tax (LOST) which expires June 30, 2019. The LOST revenues are designated for street (20%) and sewer (80%) improvements and generated \$2.8 million in fiscal 2015.

#### LIQUIDITY

The city's year-end cash balance in fiscal 2015 was \$5.0 million, equal to a strong 24.5% of operating revenues. Additional liquidity is held in the city's enterprise (\$3.3 million) and healthy insurance (\$1.0 million) funds and management reports these reserves could be used to support operations or debt service.

#### Debt and Pensions: Average Debt Burden with Limited Future Borrowing

Given the city's limited borrowing plans and rapid amortization schedule, we believe the city's debt position will remain manageable over the long term. Inclusive of the current issuance, the city's net direct debt is average at 1.4% of full value and 0.9 times operating revenue. Amortization is rapid with all debt scheduled to mature by 2026. Annual debt service requirements are also manageable with fiscal 2015 debt service equal to 13.6% of operating revenues. Total fixed costs (inclusive of debt service, pension contributions, and OPEB contributions), remain above average at 24.7% of operating revenue. Partially mitigating the above average fixed costs is the city's considerable revenue raising flexibility offered by the additional headroom under the employee benefits levy.

#### DEBT STRUCTURE

All of the city's debt is fixed rate and amortizes over the long-term.

#### DEBT-RELATED DERIVATIVES

The city has no exposure to swap agreements or derivatives.

#### PENSIONS AND OPEB

Muscatine's three-year average Moody's adjusted net pension liability (ANPL) through fiscal 2015 is \$45.5 million, equal to an above average 2.2 times operating revenue and 3.4% of full value. The ANPL is based upon an allocation of the reported unfunded liabilities of two multi-employer cost-sharing pension plans, the Iowa Public Employees Retirement System (IPERS) and Municipal Fire and Police Retirement System of Iowa. Through fiscal 2014, we allocated the liabilities and assets of the plans to the city based upon its proportionate share of public employer contributions. The plans themselves allocated asset and liability shares starting in fiscal 2015. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities. The city's fiscal 2015 contribution to the plans was \$2.1 million or 10.4% of operating revenues.

#### Management and Governance: Strong Institutional Framework and Financial Management

Iowa cities have an institutional framework score of "Aaa," or very strong. Property taxes, which are the primary revenue stream, are highly predictable despite recent property tax reform. Even with property tax caps on general and emergency levies, cities have strong revenue-raising flexibility due to various additional levies, including an unlimited levy for employee benefits. Expenditures mostly consist of personnel costs, which are highly predictable. Cities have a moderate ability to reduce expenditures due to the presence of employee unions. Many cities have elevated debt and pension burdens, but these liabilities are generally funded with unlimited tax levies.

Muscatine's management team has demonstrated its willingness and ability to maintain balanced operations through utilizing its revenue raising flexibility. This is indicated by a healthy operating ratio (five year average of operating revenues to operating expenditures) of 1.02 times. Additionally, management has instituted a formal fund balance policy to maintain an unrestricted fund balance of at least 16.7% of expenditures. Management's relationship with bargaining units is considered to be good. The current contract with all three of the city's bargaining units is settled through June 30, 2019 and allows for affordable salary increases.

#### Legal Security

Debt service on the Series 2016 Bonds is secured by the city's ad valorem property tax pledge, which is unlimited as to rate or amount.

## Use of Proceeds

Proceeds from the Series 2016 Bonds will be used to currently refund the city's callable Series 2008A Bonds and fund various capital improvement projects.

## Obligor Profile

The City of Muscatine is located along the Mississippi River, approximately 30 miles southwest of Davenport (Aa3). According to data from the 2010 Census, the city serves a resident population of 22,886.

## Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Ratings Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

## Ratings

Exhibit 3

### Muscatine (City of) IA

Issue	Rating
General Obligation Corporate Purpose and Refunding Bonds, Series 2016	Aa2
Rating Type	Underlying LT
Sale Amount	\$4,600,000
Expected Sale Date	05/05/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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